EUROPEAN UNION - JAPANESE RELATIONS:

FUTURE CONFLICT OR COOPERATION?

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Table of Contents

List of Tables

Introduction

A recent Hudson Institute study states that the end of the Cold War is but the beginning of Western Europe's emergence from a kind of cocoon.[1] This protective cocoon had, of course, been safeguarded by the U.S., which bore ultimate responsibility for the management of the Soviet security threat to the Triad (that is, the U.S., European Community, and Japan). However, with the capitulation of communist rule in the former Soviet bloc countries, the European Community (recently renamed the European Union) has begun to emerge from that cocoon. Of the three fundamentals upon which the NATO alliance rested - shared political and economic values, common economic interests, and resisting Soviet aggression - only two remain. Virtually gone is the common Soviet threat, which was the most binding of the three fundamentals. Shared political and economic values have now become the principal glue which holds together the Triad's grand alliance of the Cold War era.[2]

Shared values, however, do not guarantee that the Triad members will necessarily have shared political and economic interests. An increasingly popular futuristic view is expressed by MIT economist Lester Thurow, who

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[1]Gary Geipel and Robert Dujarric, *Europe 2005: Turbulence Ahead* (Indianapolis, Hudson Institute, 1995) p, 15.

[2]Samuel Huntington, "Why International Primacy Matters", *International Security,* Vol. 17, No. 4, Spring 1993, p. 71.

states that the cooperative economic competition of the last half of the twentieth century between the U.S., EU and Japan will evolve into conflictual competition in the twenty-first century.[3] Is this a valid concern? Does economic conflict between the U.S., EU and Japan threaten to reverse some of the post-war progress toward opening markets and economies? Has the mutual penetration of the trilateral economies grown too far and too fast? Is the twenty-first century destined to be one of what Thurow calls "head-to-head" competition in a zero-sum game rather than niche competition in which everyone can be a winner? And what role will governments play in the future? To what extent will they intercede on behalf of their constituents to either protect them from competition or force them to compete? These are the fundamental questions that this thesis sets out to examine.

In attempting to answer these questions, I will narrow the thesis' focus to the EU-Japan side of the U.S.-EU-Japan triangle. Historically, this side has been the weakest. In other words, the amount of political and economic interaction between the EU and Japan has been much less than between both entities and the U.S. Correspondingly, as Susan Strange observes,

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[3]Lester Thurow, *Head to Head: The Coming Economic Battle Among Japan, Europe, and America* (New York: William Morrow and Co, 1992) p. 30-31.

the literature on European relations with Japan, as opposed to America, is sparse in the extreme.[4]

I chose to take this approach for several reasons. First, the amount of economic "power" possessed by both the EU and Japan as measured by gross domestic product (GDP) has increased dramatically over the past several decades. Second, there is general consensus that the growth potential for East Asian markets, with which Japan is both economically and culturally well connected, will perhaps be the highest in the world during the upcoming decades. And, finally, I believe that relations with a weaker but growing partner have a predicative value when it comes to future relations with similar or stronger partners. Thus, how the EU behaves in regard to its relations with Japan would in large part foretell how it would react to the world at large. However, in order to put modern day relations between the EU and Japan into context, it is necessary to review the past. What follows, therefore, is a brief synopsis of EU-Japanese relations since the end of World War II (WWII).

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[4]Susan Strange, "European Business in Japan: A Policy Crossroads?", *Journal of Common Market Studies,* Vol. 33, No. 1, March 1995, p. 2.

Chapter One

Historical and Cultural Context

Section 1 - 1950s and 1960s: U.S. Paternalism Toward Japan Fades

The post-war period marks neither the beginning nor the end of European-Japanese relations. However, the period provides a good starting point for purposes of this thesis because it was during this period that Japan became a global economic force with which to be reckoned. Europe's involvement (or, rather, lack thereof) with Japan during this era of rapid economic expansion thus goes a long way towards explaining the difficulties of European-Japanese relations today.

In the aftermath of World War II, Japan was occupied by the United States until 1952. During this brief period of autocratic rule under General MacArthur, the United States began to rebuild Japan as a "bulwark" against the spread of communism in Asia. A United States State Department document summarized official U.S. policy by stating:

> "The general policies of the United States toward Japan are intended to support the following objectives: an independent Japan, a Japan with a viable economy, a Japan in which democratic institutions will continue

> to grow, and finally, a Japan which will once more take its place as a respected and trusted member of the society of nations."[5]

According to William Spruce, the possibility that the U.S. might not be successful was apparently never seriously considered by the U.S. government.[6] Thus, Japan received generous American aid with few strings attached and was encouraged to develop its export industries. Prior to the conclusion of the Korean War in 1953, Japan had been able to meet its requirements for food, raw materials, and machinery for economic reconstruction largely through the U.S. military's offshore procurements of items such as heavy trucks destined for use in the Korean conflict.[7] When the war ended and a large part of the American forces withdrew from the region, the U.S. continued to play a paternalistic role in its relations with Japan. It was with U.S. sponsorship that Japan's application for membership in GATT was presented to GATT members. Indeed, the U.S. considered Japan's membership in GATT vital because of Japan's continuing need to develop exports in order to finance its dependence on imports. Moreover, during occupation, the

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[5]Masamichi Hanabusa, *Trade Problems Between Japan and Western Europe,* (London: Royal Institute of International Affairs, 1979) p. 1.

[6]William Spruce, "Being Realistic About Japanese Competition: American Errors Europe Can Avoid", *European Business Journal,* Spring 1994.

[7]Albrecht Rothacher, *Economic Diplomacy Between the European Community and Japan 1959 - 1981,* (Aldershot, Hants: Gower, 1983) p.85.

U.S. permitted the Japanese to structure their capital markets in such a way that the government had strong control over foreign exchange transactions. Such control indeed helped foster the rapid growth of export industries by effectively barring potential foreign entrants from the Japanese market.[8] However, in the following decades such practices would lead to repeated allegations that the Japanese domestic market was closed to foreign competition.

Japan's application for GATT membership with U.S. sponsorship did not go unnoticed in Europe. Even though the general perception in Europe vis a vis Japan could be characterized by "lack of serious interest" concerning trade.[9] There was still very strong resentment toward Japan in many West European countries, as a result of Japan's actions during WWII. Moreover, Western Europeans' perception of Japan characterized the country as a semi-developed country with a closeted market and aggressive export practices. Much of this perception was due to aggressive Japanese business practices in the pre-war era which fanned Europeans' fears of Japanese low-wage products, trademark and patent piracy, and dumping practices.[10] The strongest

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[8]Susan Strange, "European Business in Japan: A Policy Crossroads?", *Journal of Common Market Studies,* Vol. 33, No. 1, March 1995, p. 12.

[9]Kenjiro Ishikawa, *Japan and the Challenge of Europe 1992,* (London: Royal Institute of International Affairs, 1990), p. 13.

[10]Ibid, p. 13.

opposition at this time came from the European textile industry. The following quote from an article by James Meade is representative of Europeans' feelings toward the Japanese during the late 1940s and 1950s:

> "The United Kingdom was influenced by memories of the nineteen-thirties when many existing lines of trade and production were disrupted by a sudden incursion of cheap Japanese products, sold in many cases by means of questionable commercial devices which misled customers about the origin, content or quality of the goods, which relied upon the copying of other traders' designs and which involved export subsidies..."[11]

However, U.S. support for Japan was unwavering during the 1950's, due in large part to security concerns. Japan, after all, was as much a front-line area in the Cold War with the Soviet Union as was Western Europe. In response to British, French, German and Dutch concerns over Japanese GATT membership, the U.S. engaged in frantic horse-trading, offering tariff concessions when accessing U.S. markets to those countries willing to grant most-favored-nation (MFN) treatment to Japan.[12]

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[11]James E. Meade, *Japan and the General Agreement on Tariffs and Trade,* The Joseph Fisher Lecture in Commerce (Adelaide: University of Adelaide, 1956), p. 11.

[12]Rothacher, p. 86.

In June, 1955, Japan was finally admitted into GATT. However, Britain, Belgium and the Netherlands invoked GATT Article 35 which denied Japan MFN treatment. France eventually did the same, although at a later date. Even though Germany did not invoke Article 35, it took until 1960 for Germany to implement full MFN treatment of Japan. Thus, as Rothacher has observed, "It was in the context of continued discrimination in Europe - either legally via Article 35 or in violation of GATT standards by Germany and Italy - that Japan perceived the conclusion of the Treaty of Rome in 1957."[13] In the years that followed, however, other West European countries (with the exception of France) which had invoked Article 35 gradually reconsidered and started liberalizing trade with Japan - but always under U.S. pressure to do so.[14]

Although U.S. influence in Western Europe was somewhat responsible for trade policy liberalization vis a vis Japan during the 1960s, it was by no means the only influence. Economic growth probably played the largest role. In both Western Europe and Japan, economic growth was fast-paced. Thus, the impact of

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[13]Ibid, p.90.

[14]While in the 1950s the primary motivation for U.S. support of Japan had been security related, by the 1960s it became evident that the U.S. was tiring of having to bear the brunt of Japanese exports. By 1959, 30 percent of Japanese exports were going to the U.S. at which time the U.S. advised the Japanese to cultivate new markets or face U.S. restrictions of Japanese imports.

more Japanese exports to Western Europe was lessened due to the rapid growth of the European economy itself. By 1970, Japanese imports into Europe amounted to only $1.7 billion out of $57.4 billion in total European imports (see Table 1). Since Japan did not represent even 3% of West European imports, West European nations did not regard Japan as a serious threat and therefore tended to somewhat overlook the negative aspects of European-Japanese trade.

Japan could also be conciliatory to West European demands at times - when it was convinced that it could possibly face future exclusion from European markets. Thus, in the early 1960s Japan actively started to pursue economic diplomacy towards Western Europe. Japan was convinced that the newly established European Economic Community (EEC) might develop an inward-looking trade policy to the detriment of outside countries and that such economic concentration might also subject Japanese exports to insurmountably strong future competition in third markets.[15] Also, there was talk in the 1960s of expanding the European economic alliance across the Atlantic to include the U.S. and Canada. Such a proposition (which excluded Japan) was not politically and psychologically in keeping with the growing economic strength and rising national pride of

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[15]Hanabusa, p. 4.

Japan. So politically, too, Japan needed rapprochement with Western Europe.[16]

The result of Japan's courtship of Europe in the 1960s resulted in a series of bilateral trade agreements starting with Britain in 1963. The treaties settled the GATT Article 35 dispute. However, in doing so, Japan agreed to allow the Europeans to include two types of safeguard clauses. The first allowed each country to impose import restrictions, after consultation with the Japanese, if certain imports caused or threatened "serious injury" to domestic producers. The second clause specified certain "sensitive" items such as cigarette lighters, stainless steel tableware, sewing machines, and toys to which restrictions or quotas would apply. Even though Japan thought that conceding safeguard clauses was regrettable, such compromise was necessary to ensure its access to European markets. Eventually, in 1964, Japan gained membership to the Organization for Economic Cooperation and Development (OECD), formerly an exclusive Western club, as both a reward for its compromises and at the bequest of the U.S.

In retrospect, the 1960's must have been very confusing times for the Japanese - especially in interpreting U.S. policy. Such confusion in large part

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[16]Ibid, p. 4.

is responsible for the Japanese belief that exports to Europe must be increased in order to compensate for any losses of market share in the U.S. market. The U.S. policy at the beginning of the decade, which aimed to facilitate and encourage Japanese exports, gradually changed to a policy of openly criticizing such a strategy. While the reasons for such a U-turn (a growing Japanese trade surplus and a struggling U.S. currency in international monetary markets) are obvious now, they surely would have been difficult for the Japanese to discern during the 1960s, when the Japanese economy was still in transition.

If U.S. policy at that time is seen as inconsistent and possibly nullifying earlier promises, it is little wonder that the Japanese government, encouraged by Japanese public and business opinion at the time, took steps to protect their domestic markets by erecting informal barriers that skirted GATT and to negotiate favorable bilateral trade agreements in an attempt to keep foreign competitors out. The majority view, expressed by a vice-minister of the Japanese Ministry of International Trade and Industry (MITI) in 1970 was that only by protecting high value-added industries could Japan avoid sentencing its population to the Asian pattern of stagnation and poverty as producers of textiles, toys and other goods made with

cheap labor.[17] Over time, overt government regulation of trade barriers was gradually replaced by Japanese oligopolist's private barriers - barriers still tacitly supported by the government, however.

Section 2 - 1970s: Europe Gets Defensive About Japanese Exports

By 1970, Europe was rediscovering Japan, which had previously seemed both geographically and economically far removed. It is also about this time that Japan's small trade surplus with the EEC quickly began to widen. This trend can be observed in Japan's import/export ratio which declined from 85.9 percent in 1969 to 69.9 percent in 1971 and 59.3 percent in 1972.[18] Moreover, Japanese exports to Europe became increasingly concentrated in sensitive sectors such as consumer electronics, ships, automobiles, motorcycles, and optics.

Two factors were primarily responsible for Japan's export assault on Europe at the onset of the 1970s. The first was continued U.S. pressure for Japan to curb its exports to the U.S. market. From 1968 to 1971, the U.S. trade deficit with Japan had risen from $604 million to

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[17]Strange, p. 14.

[18]Ishikawa, p. 16.

$2,634 million.[19] The second factor was that Japanese domestic demand for goods decreased in the aftermath of the 1973 oil crisis. This led to stagnation of Japanese economic growth, which had formerly been unimpeded since WWII.

Japan's export assault on Europe went virtually unchecked until 1976, when recession and unemployment caused EC member nations to raise their objections to the terms of trade with Japan through the EC Commission. This was the first time that the competence of the EC would be recognized by the Japanese. While the Commission was able to extract concessions from the Japanese on issues such as access to Japanese markets for European automobiles, milk powder imports, and voluntary export restraints (VERs) on automobiles bound for Europe, total Japanese exports to the EC continued to rise rapidly without a corresponding increase in EC exports to Japan. This occurred because Japanese exports - mostly consumer durables such as automobiles, electronic equipment, cameras, and watches - were extremely competitive in regard to price and quality and found ready buyers in Western Europe. Meanwhile, European exports to Japan did not increase as rapidly as Japanese exports to Europe for several reasons. First, protection of certain growing industrial sectors such as

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[19] Ishikawa, p.22.

the automobile and computer industries were slow to subside. And secondly, Japan's heavy dependence on imported raw materials made it practically impossible to expand imports of manufactured goods because of the associated costs. Finally, according to the EU Commission, Japan's low import propensity was based on "the protracted and unpredictable technical certification and registration procedures [for manufactured products] and above all, the habits and attitudes bred of Japan's vertically and horizontally integrated industrial, commercial and financial groups."[20] Such non-tariff barriers will be discussed in more detail in other parts of this thesis.

Such relentlessly unbalanced trade began to cause acute tension among EC member countries. Moreover, against this backdrop it is surprising that the Commission's response was no stronger than it was. Although the EC's trade import/export ratio with Japan by 1978 was 39 percent, indicating almost a 2.5:1 ratio between imports and exports, the Commission's attitude to the imbalance was somewhat ambivalent, as noted in a 1979 Commission working paper:

> "The bilateral surplus of Japan with the Community does not constitute in itself, in a multilateral world, a cause for complaint. We [the

[20]Ishikawa, p. 32.

> Community] have for example now a very substantial trade surplus with countries such as Austria, Australia, and Yugoslavia and that is why we would not be satisfied if the countries concerned adopted countermeasures."[21]

The likely explanation for such diffidence was that the Community's *overall* balance-of-payments situation with all other trading partners was quite strong. Several times during the decade the Community's overall trade balance was in surplus.[22] Thus, a $6.4 billion deficit with Japan in 1978 did not appear to be a grave danger in light of the fact that trade with Japan amounted to only about 2 percent of all EC external trade (Table 2).

Still, however, "diffidence" is not quite the right word to describe the Commission's attitude. The Commission was concerned with three things. First, the deficit with Japan, although a small part of total external trade, was continuing to grow much faster than overall growth of Community exports. Second, the Japanese were concentrating their exports in primarily the machinery and equipment sectors, with products such as automobiles, scientific and optical equipment, office

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[21]Commission of the European Communities, *Japan: Consultations in Train and Envsaged - Working Paper of the DGI - on the Agenda for 509th Meeting of the Commission on 21.3.1979, Item 11,* 19 March 1979.

[22]Ishikawa, p. 23.

machinery, and audio and video cassette recorders being most representative. Third, the Japanese were keeping their imports of finished goods as opposed to raw materials at an artificially low level - only about one-fifth of total imports.

In summarizing European-Japanese relations in the 1970s, then, one could say that Europe's posture was defensive. By the later part of the decade, the Japanese agreed to use VERs for goods that competed too successfully with like European goods. (VERs were the preferred method of limiting imports for European countries, as opposed to resorting to the safeguard clauses contained in most bilateral trade treaties between EC member states and Japan). VERs were negotiated either by industries, by governments or by the EC Commission and they covered a very large part of the total of Japanese exports to the EC. In addition to using VERs, the Japanese would sometimes raise prices on exports. However, the result Europeans hoped for did not materialize. Demand for Japanese goods remained brisk.

In reflecting upon this situation in a 1979 Commission-internal document, which was later leaked to the press, the Commission stated that the reasons for the Japanese surplus with Europe was not so much unfair Japanese trading practices or non-tariff barriers. Rather, it was the lack of competitiveness of certain

European industries compared with their Japanese counterparts.[23] But rather than use the time afforded by VERs to restructure their industries to be more competitive with the Japanese, European countries seemed either unable to appreciate the nature of the challenge facing them or unable to adapt. The decline of the European textiles industry was followed by shipbuilding, which in turn was followed by steel. And in some European countries, the home electronics and automobile industries had begun to already falter by the mid-1970s.

Section 3 - 1980s: Europe Attempts to Regain the Offensive

By 1980, Europe was again in recession as the result of the second oil shock in 1979. The decline of key industries in the EC, many of which employed millions of workers, produced a highly charged atmosphere in which scapegoats were sought. Domestically, the blame was laid on trade unions, management, and the welfare state. Abroad, the obvious candidate for scapegoat was the country whose export industries were so successfully cutting a swathe into European and world markets, namely Japan.

[23]Wilkinson, p. 208.

By 1980 the EC Commission had also switched from a primarily defensive stance of attempting to minimize the impact of Japanese exports in the European marketplace to an offensive stance of trying to get better access to Japanese markets. The Commission's position was largely in response to member countries' frantic calls for protection against Japanese imports. Even Germany, traditionally the staunchest backer of free trade in the EC, was calling for protection by 1980. Such fear on the part of Europeans can be somewhat explained when Japanese penetration into European automobile markets is examined.

By 1980, thanks to a timely adaptation of their industry to producing reliable energy-saving cars, the Japanese had become the world's number one manufacturer and exporter of cars. Sales of Japanese cars in the EC accounted for 11.1 percent of all cars sold in Europe - a twenty-fold increase since 1970 (Table 3). Moreover, by 1980, Japanese wages in the car industry were now above the European average for all industries.[24] Japanese workers worked longer hours than their European counterparts. However, they were less frequently absent and they took fewer paid holidays. Most important of all, Japanese investment in advanced technology and huge production runs contributed to the much higher

[24]Wilkinson, p. 178.

productivity of the Japanese car industry compared with that of Europe. The result was that prices for Japanese cars were not nearly as high as for comparable European or American models.

Meanwhile, European car sales in Japan had not even doubled since 1970. In 1980, European automobile imports in Japan accounted for only 1.1 percent of automobile sales in Japan. There was also production over-capacity among the EC automobile producers. The French Peugeot group (to include Citroen and Talbot), British Leyland of the United Kingdom, Fiat of Italy, General Motors in the United Kingdom and Ford in West Germany were all piling up substantial losses.[25] In October 1980 Bernard Hanon, then managing director of Renault, called for a bold protectionist policy to prevent Japanese automobiles from flooding the EC market. He stated;

> "Action is needed because Japan indulges in unfair competition, in that she is fifteen years behind her competitors in terms of giving social benefits to workers, and since Renault exports more than half its output, it cannot afford to be protectionist in outlook. But trade with Japan is exceptional because of the way imports are shut out. Renault produced two million cars in

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[25]Ishikawa, p. 25.

> 1979, but was only able to export 500 cars to Japan."[26]

In its attempt to gain better access to Japanese markets, the Commission focused on what it called "informal barriers" or "quasi non-tariff barriers" - barriers that were supposed to have been removed by the Japanese in 1979 when they agreed to be more accessible to the West. In April 1982, the Commission representative to the GATT in Geneva complained to the Japanese that there had been no substantial progress in opening the Japanese market and this lack of progress was in violation of international trade treaties. The Community's complaints were summarized in a Commission paper. Specifically they were:

> "-A great number of unnecessarily complicated, over-administered rules, regulations and standards, many of which are in substance outdated and unreasonable; as well as objectively unjustified requests for repetition of tests which had been already performed by first-class testing institutions and which are generally accepted everywhere else.
> -What the Jones Committee Report of the U.S. Congress of September 1980 terms 'cultural barriers to imports' or 'private sector quasi-NTBs'. These include attitudes and structures in day-to-day business which make it more difficult than in

[26] *The Financial Times,* 11 October 1980.

> the Community or elsewhere for the outsider to come in; big business groupings; vertical affiliations of large, medium and small firms ('Keiretsu'); peculiar trade financing and credit access; lack of independent dealerships in certain sectors; interlocking 'dictatorships'; a great number of industry and business associations - partly formed under government auspices - which tend to take on regulatory functions in some aspects similar to the medieval Guilds in Europe; and collective defense reactions against newcomers from outside."[27]

As noted above, the Commission's complaints focused on three main areas: distribution of products in Japan, government "guidance" to industry, and other non-tariff barriers such as taxes, public procurement, standards, testing and certification procedures, import procedures, intellectual property rights, service and labeling.[28] Regarding distribution, the main thrust of the argument was that while the complex distribution system for goods in Japan was non-discriminatory in the sense that the same channels distribute both domestic and imported products, it was discriminatory because vertically integrated Japanese producers controlled and limited channels of distribution. The result was that there was only a sole distributor for many products in Japan

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[27]The Commission of the European Communities, *EC-Japan Relations; Arguments and Counter-Arguments*, Brussels, April 1982, p. 5.

[28]Ishikawa, pp. 34-39.

which, in turn, European distributors alleged, prevented European products from gaining acceptance in Japan.

In regards to administrative guidance, a European Parliament document, which argued that the Japanese government exerted pressure on industry to limit foreign imports, specifically said that "the Japanese Ministry of International Trade and Industry (MITI) and other ministries have in the past kept a close regulatory eye on the business sectors requiring either protection or development and this has meant excluding importers' products in the same sphere."[29] A 1985 OECD document partially refutes this assertion however, saying that such Japanese practices for the most part ended by 1971. It stated:

> "Government policy has played an important role in fostering key microelectronics industries, especially at the initial stage of development. Indeed all OECD countries directly or indirectly assist and promote their electronics industries. Before 1971, access to Japan's market was generally limited by import quotas. Foreign direct investment in strategic areas (notably semiconductors and computers) was restricted, effectively preventing foreign firms - which had a technological lead - from entering. At a formative stage, the domestic market was reserved for

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[29]European Parliament, *On Trade Relations Between the EEC and Japan*, 3 June, 1981.

> Japanese industry. From 1971, however, successive measures of trade and capital liberalization were taken."[30]

With regard to the other numerous alleged non-tariff barriers to which the Commission makes reference, Gary Saxanhouse notes that "there is nothing abnormal about Japanese trade and industrial patterns...[However] there is evidence that Japan does have a distinctive trade structure by comparison with other advanced industrial economies, but only because the Japanese economy's other attributes are also distinctive."[31] True, Japan does indeed have standards and certification procedures for manufactured goods. Yet Europe does also.[32] The point Saxanhouse makes is that just because Japan's system is different does not make it wrong or in violation of existing treaties.

Japan's general response to European complaints of this nature has been that European businessmen should make greater efforts on the Japanese market. As evidence of Europeans not trying hard enough, Endymion

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[30]OECD, *Japan - Economic Surveys,* 1985 pp. 45-46.

[31]Gary Saxanhouse, "The Micro-and Macro Economies of Foreign Sales to Japan" in William R Cline (ed.), *Trade Policy in the 1980s,* (Washington D.C.: Institute for International Economics, 1983).

[32]A 1 April 1996 *Wall Street Journal* article entitled "Europe's Unity Undoes a U.S. Exporter" describes how a U.S. exporter of flexible hose connectors for gas appliances is prohibited from getting his product to market in Europe because it "threatens public safety" according to EC standards. That exporters response was: "My [EU] competitors basically wrote the rules to describe their own products."

Wilkinson utilizes some unusual evidence. According to him, in 1980, in Germany alone, which at that time had the largest concentration of Japanese companies in Europe, there were no less that 430 Japanese business offices and 13,500 resident Japanese. In 1981, hotels in just Dusseldorf registered 64,000 Japanese businessmen.[33]

Because Europe is a much larger market than Japan, one would expect three or four times more Japanese there. However, if you look at European business presence in Japan at the same time, the figures are way below what one would expect. In 1981, in all of Japan, only 62,000 European businessmen visited. (This figure was determined by the number of short term commercial visas issued by Japan). Thus, the number of European businessmen visiting Japan amounted to less than the number of Japanese businessmen who came to just Dusseldorf.[34]

European investment in Japan is another telling sign. In 1980 the accumulated direct investments of all nine EC countries in Japan amounted to $340 million. The United States, on the other hand, had $1.5 billion invested in Japan by 1980. Meanwhile, in the same year, Japanese investments in the EC totaled $3.7 billion -

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[33]Wilkenson, p. 212.

[34]Ibid, p. 213.

ten times more that the EC had invested in Japan.[35] While it could be argued that the Japanese barriers to trade and investment were higher than European ones, Kenjiro Ishikawa of the Royal Institute of International Affairs comments:

> "Over the past year or two, however, there have been some positive developments in trade and economic relations between the Community and Japan. Japan has moved towards less export-dependent economic growth, reflecting precisely the kind of structrual adjustments that outsiders desire, and its tariff and non-tariff barriers(NTBs) are now among the lowest of those of the major industrialized countries."[36]

So, for whatever reasons, European business did not make great strides in making inroads into the Japanese market during the 1980s. In addition to perceived Japanese barriers to entry, it is likely companies were somewhat distracted by the European Single Act in 1987 and consequently focused their attentions inward on the ramifications of the single market rather than outward. The same can be said in regard to the focus of the Commission.

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[35] Wilkenson, p. 214.

[36] ishikawa, p. XIV.

As the Community began to educate the world upon the finer points of the coming single market, phrases such as "balance of benefits" emerged.[37] To the external world this phrase seemed to imply an equivalence of outcomes - in other words, reciprocity. This alarmed the outside world because precise balances of trade or of exports and imports are inconsistent with free competition or liberalization. Thus, the Community now appeared to be seeking equality of outcome rather than equality of opportunity. This fear was further reinforced in July 1988 in a widely quoted speech when Commission member Willy de Clercq stated:

> "We see no reason why the benefits of our liberalization should be extended unilaterally to third countries. We shall be ready and willing to negotiate reciprocal concessions with third countries, preferably in a multilateral context, but also bilaterally. We want to open our benefits, but on the basis of a mutual balance of advantages in the spirit of the GATT."[38]

With that said, the EC spent the remainder of the decade in what appeared an attempt to tone down its rhetoric of a year earlier and allay fears that Europe was becoming more protectionist. In a Commission document which set forth EC external policy strategy

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[37]Ishikawa, p. 119.

[38]Ibid, p. 121.

after 1992, the Commission stressed that the Community's concept of "reciprocity" does not mean that all partners must make the same concessions.[39] Moreover, in April 1989, Martin Bangemann, Vice President of the Commission, surprised the Community's automobile industry and member governments by proposing that the national quotas on Japanese cars imposed by five member states be lifted in 1993 and that no Community-wide import quota be introduced as a replacement.

Finally, in attempting to summarize the 1980s in terms of European-Japanese trade relations, two themes stand out. First, faced with continually rising trade deficits with Japan in a limited number of industry segments, the Europeans attempted to remedy what they believed was an access problem to the Japanese markets. Little progress was made along this front, however. And secondly, by the end of the decade, Europe appears to be becoming more protectionist again, demanding equal outcomes with trading partners as opposed to equal opportunity.

[39] Ibid, p. 123.

Chapter Two

Post-War International Relations Theory

Introduction

In the thesis' Introduction the question was asked whether the twenty-first century would be one characterized by economic conflict or cooperation between the EC and Japan. As is evident from Chapter 1, by the end of the 1980s, the ingredients for increased economic conflict between the EC and Japan seem to be present. EU statements did little to ally outside fears that the EC was becoming more protectionist and on the path to a "Fortress Europe". These fears were exacerbated by weak economic growth and increasing unemployment throughout the Community. As John McIntyre observed in 1984, "It is only in the most recent years that the Japanese attitude towards post-Second World War Europe shifted from one of mild condescension to one of acute concern . . . The Europeans have indicated informally that the Community will be looking for ways to limit Japan's ability to reap the benefits of a more integrated [EC] regional market."[40] To Japan and the rest of the industrialized world then, Western Europe

[40]John McIntyre, "Europe 1992 and Japan's Relations With Western Europe", in *Japan, NAFTA, and Europe: Trilateral Cooperation or Confrontation?* (New York: St Martin's Press, 1994) p. 59.

seemed on the verge of becoming a "fortress", protecting itself by trying to exclude outsiders.

The 1990s should either confirm of reject the trend identified above. So far, the evidence suggests that the EU is not turning inward. Rather, it is becoming "a leader, not a straggler, in the drive for further global liberalization."[41] According to the *Financial Times*, such EU action is a response to a "perception in Brussels that the U.S. has, at least temporarily, abandoned an active international trade policy role."[42] The article goes on to say that because European exporters feel that they are suffering currently, or will be likely to in the future, from exclusion from foreign markets characterized by preferential regional trading blocs, the EU has emerged as the champion of a multilateral trading system officiated by a multinational organization - the World Trade Organization (WTO).

However, champion of a *multilateral* trading system does not exactly square with an observation of Thurow in *Head to Head* when he states, "The Europeans also have the advantage of getting to write the trading rules for the twenty-first century. Those who write the rules will not surprisingly write rules that favor those who

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[41]*Financial Times,* "EU Embraces the Cause of Free Trade", 6 August 1996.

[42]Ibid.

play the game the European way."[43] Clearly, however, the Europeans cannot believe that the WTO will side with the European cause every time. But still, they champion its mission of international trade rule maker and arbiter. It thus appears, based on the EU's actions, that Thurow's prediction of nobody wanting a "level playing field" and everybody "wanting an edge" might not be becoming reality.[44]

Why has the EU opted to cede sovereignty to a multinational institution such as the WTO over which it has little power? The answer is that it has no alternatives more attractive than open global trade.[45] The EU needs access to foreign markets to sell its goods and it needs foreign investment to create jobs in Europe. However, such action is a *volte face* from past European protectionist practices.

While such a change on the part of Europeans may seem radical at first glance, during the past decade revisionist theories of international relations have predicted such an outcome. Thus, a closer examination of these theories will yield a better understanding of the global stage upon which Western Europe is playing.

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[43]Thurow, p. 253.

[44]When Thurow published *Head to Head* in 1992 the WTO had not yet been created and it appears from his thesis that he did not believe it would be created.

[45]*Financial Times*, 6 August 1996.

This is the purpose of Section 1 of this chapter - to examine those theories. In Sections 2 and 3, the concepts of trade and competition are superimposed on the concepts of interdependence and global economy developed in Section 1. In these sections, minority opinions devaluing the importance to international trade are critiqued in order to show that international trade is indeed very important to the international system.

Section 1 - The Theories of Hegemonic Stability and Complex Interdependence

As pointed out in the previous chapter, from the end of WWII onward, the United States provided the security umbrella under which the rest of the Western World economically prospered. At the same time, the U.S. also chose and enforced a liberal set of rules for a system of international economic interaction. Such an international system was characterized by monetary and exchange stability, free trade, and a high potential for economic growth. Conservative and radical commentators alike regarded U.S. dominance as the central reality in contemporary world politics.[46] In Robert Keohane's words, the U.S. was "astride the world like a colossus."

[46]Robert Keohane, "The Theory of Hegemonic Stability and Changes in International Economic Regimes, 1967-1977", *International Political Economy: State-Market Relations in the Changing Global Order*, (Boulder: Lynne Rienner Publishers, 1996) p. 90.

The actions of the United States in the post-war world are illustrative of a theory of power called hegemonic stability. According to this theory, strong international economic regimes depend on a hegemonic power.[47] Thurow nicely illustrates this premise in *Head to Head* when he says:

> "Because of its size, America served as a locomotive for the world economy . . . Whenever the world sank into a recession, to prevent it from becoming a depression the United States would use its fiscal and monetary policies to stimulate demand - benefiting both American and foreign producers . . . But with success, the American locomotive gradually grew too small to pull the rest of the world." [48]

As Thurow suggests, the hegemonic decline of the United States, especially in regards to international economic relations, was a gradual process. However, many historians agree that the oil crisis of 1973 was the one event that perhaps best illustrated that decline.

The inability of the United States to either prevent or counteract the oil price increases of 1973-1974 seemed to symbolize the drastic changes that had taken place. Unemployment rates in the West almost

[47]Ibid, p. 90.

[48]Thurow, p. 58.

doubled while inflation rates increased almost threefold. Surplus capacity appeared in the steel, textiles and shipbuilding industries. Furthermore, confidence that Keynesian economic policies (government economic intervention to balance production capacity with the propensity to consume) could ensure uninterrupted growth had been undermined, if not shattered.

But if the former hegemon (the U.S.) is no longer a hegemon, what happens to the international economic regime that thrived under the hegemon's oversight? Was the EU somehow destined to assume the leadership role that it has of late in championing a multilateral trading system, or was it quite by accident? In answering this question it is first necessary to distinguish between two different theories of international relations.

The first theory, known as realist thought, of which the aforementioned notion of hegemonic stability is part, contends that the state is the dominant actor in world politics and that military force and violence are the primary means by which states achieve their goals. According to this theory, the "high politics" of military security dominates the "low politics" of economic and social affairs. Each state attempts to defend its territory and interests from real or perceived threats. Political integration among states

is slight and lasts only as long as it serves the national interests of the most powerful states. Transnational actors either do not exist or are politically unimportant. While pure realist thought may have characterized international relations very well during the Cold War, current international issues do not seem to fit well within its parameters. This is where the revisionist theory of complex interdependence comes in.

The theory of complex interdependence emphasizes cooperation rather than conflict.[49] The notion of complex interdependence does not purport that violence and conflict have disappeared; rather, they have been subordinated to nonsecurity-related issues such as international trade, monetary relations, and environmental concerns. Use of military force has been subordinated, writes Francis Fukuyama, because of overwhelming world agreement about the virtues of Western liberal democracy.[50] As William Nester points out, "Since 1815, liberal democracies have never gone to war [with one another]."[51]

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[49]Robert Keohane and Joseph Nye, *Power and Interdependence: World Politics in Transition, (Glenview,Il: HarperCollins College Publishers, 1989)*.

[50]Francis Fukuyama, "The End of History?" *The National Interest,* No. 16, Summer 1989, p. 3.

[51]William Nester, *International Relations: Geopolitical and Geoeconomics Conflict and Cooperation,* (New York: HarperCollins College Publishers, 1995), p. 454.

According to Fukuyama, liberal democracy has emerged triumphant from a 7,000 year dialectical struggle between different ideologies. He notes that history is ending in a Hegelian sense and bringing with it an unprecedented and unending era of peace among humanity. Along with this era of peace comes an increase in the number of channels which connect societies. Relations become transnational rather than transgovernmental, with nongovernmental elites and business leaders of multinational corporations playing increasingly greater roles. Formalized relations among states still exist as realist theory would predict. However, their relative importance lessens under the complex interdependence theory. Thus, according to the notion of complex interdependence, day-to-day affairs of states have more to do with promoting cooperative economic and other social interactions than with military and security matters.

While the concept of complex interdependence characterizes today's world better than realist thought, it still misses the mark slightly - especially in regards to "cooperative actions among states." In a truly cooperative system, one would expect to find little resistance to an international arbiter such as the WTO. However, this is not the case as Thurow points

out when he says that, "Increasingly, countries are making themselves judges of their own trade disputes."[52]

Charles Krauthammer even swings further back towards realist thought by arguing that the Gulf War marked the beginning of a "Pax Americana" in which the world will acquiesce to benign American hegemony.[53] However, other modern realists devalue military power to a larger extent and instead define power in today's world in economic terms. Clyde Prestowitz, who adheres to this view, cites Victor Hugo in buttressing his thesis that economics will be the key to world affairs in the future. Hugo states, "Markets, open to trade, and minds, open to ideas, will become the sole battlefields."[54]

Similarly in *Head to Head,* Lester Thurow states that "military power does not lead to economic power . . While military power can sometimes outlast economic power . . . eventually military power depends upon having a successful economic base . . . [The U.S.] success in the Gulf in no way guarantees that it will be an economic superpower in the twenty-first century."[55]

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[52]Thurow, p. 63.

[53]Charles Krauthammer, "The Unipolar Moment" in *Rethinking American Security: Beyond Cold War to New World Order,* Graham T. Allison and Gregory F. Treverton, eds., (New York: Norton, 1992).

[54]Clyde Prestowitz, "Beyond Laissez Faire", *Foreign Policy,* No. 87, Summer 1992, p. 67.

[55]Thurow, p. 20.

Likewise, Thurow and Paul Kennedy[56] cite numerous historical examples of "imperial overstrech" where excessive defense spending crowds out private investment, lowers economic growth, and ultimately brings down great powers.

In summary, then, theory suggests that power in today's world has largely shifted from being defined in military terms to economic terms. Realist theory purports the notion that there still must be a hegemon or quasi-hegemon managing such a system. The theory of complex interdependence, on the other hand, suggests that management is not contingent upon power and that states will either willfully cooperate with one another or willfully designate a referee (such as the WTO) to settle any disputes that might arise. A state's willingness to do the latter, however, depends largely upon how it views international trade. If it believes it can consistently win, it should have little opposition to a multilateral system. However, if it perceives that it might be a "loser", other alternatives to cooperative free trade begin to look more attractive. In the next section, the concept of everyone being a "winner" as the result of trading is examined in order to better assess whether European-Japanese trade

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[56]Paul Kennedy, *The Rise and Fall of the Great Powers,* (New York: Random House, 1987).

relations of the future will be characterized by conflict or cooperation.

Section 2 - Is Trade Still Win-Win?

As pointed out in the previous section, the theory that worldwide convergence of liberal democratic ideals has eliminated the ideological basis for conflict does not specifically address economic issues. If economics is seen predominantly as an internal issue within the confines of nation-states, it would follow that each nation would generally be self-sufficient and depend little on its neighbors. Thus, there would be little impetus for conflict. Likewise, if raw materials (natural resources) and manufactured goods are unavailable internally and are required from external sources, (such a dependence has characterized Japan and to a lesser extent, Europe, in the post-war era) stability should persist as long as their availability is unencumbered.

Since it is prohibitively costly to produce everything internally, states have tended to depend on trade with each other to a certain degree. Trade is seen as an efficient use of resources and beneficial to all involved. It allows partners to specialize in certain areas where one partner has an advantage in certain factors of production over the other

(comparative advantage). Thus, external trade has a stabilizing influence as long as all parties view it as a mutual benefit - in other words, win-win.

The high interdependence resulting from trade can be peace-inducing as long as states expect future trade levels to be high. If, however, a highly dependent state expects future trade to be low due to certain policy decisions on the other side, other alternatives become more attractive.[57] Such alternatives would include protectionism or strategic trade policy (neomercantilism), which aims at nurturing and protecting "key" or critical industries. William Nester comments, "In an increasingly interdependent global economy, most governments will become more neomercantilist as their nations' dependence on international trade steadily deepens."[58] International security analyst Samuel Huntington adds, "The idea that economics is a non-zero-sum game (win-win) is a favorite concept of tenured academics. It has little connection to reality."[59]

Lester Thurow characterized the twentieth century as one of win-win niche competition. Using America as

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[57]Dale Copeland, "Economic Interdependence and War: A Theory of Trade Expectations", *International Security,* Vol. 20, No. 4, Spring 1996, p. 17.

[58]Nester, p. 335.

[59]Samuel Huntington, "Why International Primacy Matters," *International Security,* Vol. 17, No. 4, Spring 1993, p. 72.

an example, he cites how American exports did not threaten good jobs in West Germany or Japan. The U.S. exported agricultural products that the Europeans or Germans could not grow, raw materials that they did not have, and high technology products they could not build.[60] However, as Thurow points out, the U.S. no longer leads in everything. According to Thurow, the U.S. has fallen behind both Japan and Germany in terms of inventing new manufacturing process technologies and in terms of investing in the skills of workers. The EU countries and Japan have also caught up in terms of per capita GNP and have the same vision of what industrial sectors will provide the highest growth in the twenty-first century - namely, microelectronics, biotechnology, new materials sciences, telecommunications, civilian aviation, robotics, machine tools, and computers.

For Thurow, the twenty-first century will be head-to-head, in other words win-lose, competition fought primarily in the industrial sectors listed above. In buttressing his claim, he cites several authors and public officials in Europe and Japan who all believe that their countries will be the "winners" in the economic "wars" of the twenty-first century.[61] For example, Shintaro Ishihara, author of the book *The Japan*

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[60]Thurow, p. 29.

[61]Ibid, p. 30-31

That Can Say No, states that the superpower military warfare of the twentieth century will be replaced by economic warfare in the twenty-first century, and that Japan will be the winner of the twenty-first century's economic wars. Similarly, Thurow cites Chancellor Helmut Kohl of Germany, who in February 1990 on German television stated: "The 1990s will be the decade of the Europeans and not that of the Japanese."[62]

Section 3 - Are Nation-States Really in Economic Competition with One Another?

Based on the discussion of the previous section, the argument is made that modern advanced industrial countries compete with each other for market share of similar manufactured goods and services. However, if this really is the case, to what extent does such competition lead to cooperation or conflict, the question posed in the chapter's introduction?

In a recent article in *Foreign Affairs,* Stanford economist Paul Krugman takes a stand that countries do not compete head-to-head. He explains that "the idea that a country's economic fortunes are largely determined by its success on world markets is a

[62]Ibid, p. 31.

hypothesis, not a necessary truth."[63] He goes on to explain that "for an economy with very little international trade, competitiveness would turn out to be a funny way of saying 'productivity' and would have nothing to do with international competition."[64] The growth rate of living standards would essentially equal the growth rate of domestic productivity and not productivity relative to competitors.

To illustrate this point and his belief that countries do not compete head-to-head like corporations, he uses the following analogy with pure head-to-head rivals Coke and Pepsi: "[In the U.S.], only a negligible fraction of Coca-Cola's sales go to Pepsi workers [and likewise], only a negligible fraction of the goods Coca-Cola workers buy are Pepsi products. So if Pepsi is successful, it tends to be at Coke's expense. But [in the case of] major industrial countries, while they sell products that compete with each other, they are also each other's main export markets and each other's main suppliers of useful imports."[65] Thus, while there is some pure head-to-head competition, it tends to be only a small slice of a big "economic pie".

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[63]Paul Krugman, "Competitiveness: A Dangerous Obsession", in *Foreign Affairs*, Vol. 73, No. 2, March/April 1994, p. 30.

[64]Paul Krugman, p. 32.

[65]Ibid, p. 34.

Thus, for Krugman, a Japanese economy that does well does so at a very small cost to Europe. If anything, in his opinion, it is likely to help the European economy by providing it with larger markets and selling it superior quality goods at lower prices, thus benefiting European consumers. Also, such strength would likely lead to increased Japanese investment in Europe which would likely lead to more job creation in Europe for Europeans.

However, Krugman's argument is a minority view and only works if 1) international trade is small and 2) if exporting countries import many of the same products they export. But neither is really the case when applied to EU-Japanese trade relations. EU external trade now accounts for over 13 percent of EU GDP (Table 4) and the total value of trade with Japan is around $100 billion annually. Moreover, as Peter Drucker points out, Japan tends to severely limit importing any of the products it exports as opposed to EU countries and the U.S., which sell and purchase a wide range of goods, based mostly on consumer preference and comparative advantage.[66] While free traders would argue that such practices on the part of Japan are not of great importance as long as they do not significantly alter the overall increasing level of trade (Table 5),

[66]Peter Drucker, Editorial, *Wall Street Journal,* 1 April 1986.

others cite the inefficient domestic adjustment costs that such foreign practices necessitate as well as terms-of-trade losses.[67] Thurow elaborates on this concept when he states,

> "It is possible to show theoretically that free trade maximizes national incomes [and that] the winnings of winners will be larger than the loses of losers. [However], significant time lags exist. [For example], workers fired in any industry losing market share to imports [do not] quickly find work elsewhere. [Likewise] new plant and equipment for restructured industry takes time to build."[68]

Per capita import levels between Japan and EU show that Japan actually imports more per capita from the EU than the EU imports from Japan (Table 6). Yet, imports of high value added manufactured goods is skewed toward the EU (Table 7). As Clyde Prestowitz observes, what a country manufactures matters profoundly.[69]

Some industries, he argues, experience very rapid growth, increases in productivity, reductions in costs, and have major spillovers into other sectors. According

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[67]An example of a terms-of-trade loss would be if Japan, for example, subsidized their automobile industry while Europeans did not. As a result, Europeans automobile manufacturers might have to lower their own prices to match their Japanese competitors'.

[68]Thurow, p. 82-83.

[69]Prestowitz, p. 70.

to Prestowitz, such industries contribute more to economic welfare than others. He cites the semiconductor business as an example because it sparked the personal computer industry and led to increases in productivity in such industries as the aircraft industry where aircraft design is now done by super computers. He also argues that such industries bring greater training and wages to workers. In his words, "Unique or complex production of goods such as 747 aircraft or microprocessors requires training and skills that bending hula hoops does not."[70] In his referenced article, Prestowitz is advocating that the U.S. adopt a strategy to put increased emphasis on such high value industries because, in his opinion, the U.S. is falling behind Europe and Japan. In a similar fashion, Leon Brittan, European Commissioner responsible for trade states:

> "It Europe is to gear up its industry and services sector to the fight for future survival, it must put aside its ideological baggage and carry on the most detailed, rigorous and dispassionate analysis of what makes European industry tick, as well as what makes some sectors strong and others weak. [We] must begin from the premise that Europe is growing ever more interdependent on its world partners... To revive Europe's

[70]Ibid, p. 71.

> flagging economy, its companies must install a new 'quality culture' capable of producing new ideas and turning them rapidly into goods and services that create and win markets on a global scale.... [But Europe is still] weak in the lucrative technologies of tomorrow - electronics communications, and other information technologies."[71]

Brittan goes on to argue that Europe is the odd man out of the technology triangle buying more high-tech products from the U.S. and Japan than it sells to them. Moreover, Europe imports more technology from all its developed and rapidly developing partners than it exports. According to Brittan, this gap is widening on account of the fact that Europe's high-tech sales overseas are growing at only half the rate of its imports. Moreover, Brittan cites the more numerous alliances between American and Japanese high-tech companies as opposed to similar Japanese and European companies as being an indicator of declining European competitiveness in high-tech industries.

At this point in this chapter, the idea that trade can be beneficial to all parties should be clear. While Krugman's argument that head-to-head competition in certain high-tech product areas is not significant in the aggregate, consensus suggests otherwise. The

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[71]Leon Brittan, *Europe: The Europe We Need,* (London, Hamish Hamilton, 1994) p. 68-69.

consensus opinion advanced by Thurow and Prestowitz suggests that future rapid growth in advanced industrialized countries lies in high-tech product areas. Given this set of circumstances, trade can still be win-win, but competitiveness and common rules become essential.

In regards to competitiveness, a vast literature on industrial strategy and policy has emerged in response to countries' needs to stay competitive.[72] The basic gist of such literature is that technology-intensive industries violate the assumptions of free trade theory. According to this theory, as the scale of such industries increases, technology spills over to aid other industries. Being a "first-mover" in such advanced technologies theoretically becomes an advantage. Governments attempt to assist cutting-edge industries in numerous ways to include subsidies, tax breaks, protection from other competition etc... In short, the characteristic features of high technology industries - imperfect competition, strategic behavior, dynamic economics of scale, and technological externalities - provide a fertile breeding ground for interventionist policies.[73]

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[72]See, for instance, Laura D'Andrea Tyson, *Who's Bashing Whom: Trade Conflict in High-Technology Industries,* (Washington D.C.: Institute for International Economics, 1993).

[73]Tyson, p. 4.

While it is unquestionable that both EU and member state governments and the Japanese government have intervened on behalf of industry in the past, the effectiveness of such intervention is very questionable. The European "national champions" of the 1970s were deregulated and privatized in the 1980s to make them more competitive. Even in Japan, while protection and government assistance enabled developing export industries to get a foothold in the market, once they matured, the government moved away from providing support and allowed international competition drive their further growth.

In regards to common rules, this chapter began with the observation that the EU has started to take a leading role in advocating a multilateral trading system administered by a "neutral" referee - the WTO. This position is in direct contrast to Thurow's observations that nations are increasingly judging their own trade disputes. It is also in sharp contrast to protectionist European policies of twenty years earlier. However, the world is very different today than it was twenty years ago. Today it is more interdependent and the need to increase living standards is near the top of the political agenda of all Triad countries. The driving force behind the EU advocating such an open system is that it feels it has no better alternative if it wants

to improve living standards for its populace in the long run.

As the chapter has pointed out, trade among Triad countries is beneficial to all, but has become increasingly concentrated in high-technology areas. As a result of such concentrations competition has become more intense. Thus, it is more important than ever for Western Europe to have access to foreign markets and capital to continue to develop its high-tech industries which some argue are "behind" those of the U.S. and Japan. It is counterproductive, therefore, to turn inward in an attempt to exclude competitors - even when many on the domestic front in Europe advocate otherwise, especially in light of the high unemployment situation.

Paul Krugman was cited in the chapter as believeing that competitiveness was a "dangerous obsession" and likely to evoke needless conflict. However, as the next chapter will show, competition is good. It is win-win and does not have to be conflictual - as long as it is perceived as fair. Ultimately, it brings needed change for long-term economic growth but not without some domestic pain in the short-term.

Chapter Three

The Case of the European Automobile Industry

Introduction

While the automotive industry is not really characteristic of the high-tech industries of the future that Thurow and Prestowitz describe as the battlegrounds of the twenty-first century, (although it yields higher value-added then the aerospace and electrical engineering industries which do fall under the high-tech banner). (See Table 8) it does shed a great deal of light on the conflict or cooperation question of future EU-Japan relations for several reasons. First, the automotive industries in both Europe and Japan employ a large number of workers (Table 9 & 10).[74] In terms of the twelve member states of the EC, the automotive sector as a whole accounted for 10 percent of manufacturing output. In Germany alone it has been estimated to account for as much as 20 percent of GDP and has certainly been the power-house behind the German economic growth record.[75] Western Europe as a whole

[74]Table 9 shows approximately 1.5 million autoworkers between Germany, France and the UK in 1981. Table 10 shows an approximate decline of 20% of the workforce EU-wide from 1984-1994. 20% applied to the 1.5 million figure for Germany, France and the UK would be a decline of 200,000.

[75]Peter Wells and Michael Tawlinson, *The New European Automobile Industry,* (New York: St Martin's Press, 1994), p. 1.

currently accounts for 28 percent of world automotive production and 33 percent of world automotive sales. Thus, in simple economic terms, the industry is of strategic importance to Europe.

The second reason that the automotive industry merits further analysis is that in both Europe and Japan it has to varying degrees in the past been protected from outside competition. In Italy, for example, in 1987, only 2,550 cars and 750 off-road vehicles were directly imported from Japan due to Italian quotas (QRs) - the strictest in Europe. And in Britain, (which in contrast with Italy looks generous) Japanese car sales have been and still are limited to 11 percent of its market by means of negotiated voluntary export restraints (VERs) with the Japanese.

Section 1 - The State of the European Automobile Industry Today

After years of bitter bickering between the EU Commission and its most protectionist members, Italy and France, an agreement was reached in 1991 which called for lifting all restrictions to Japanese automobile imports by 1999. To date it appears that the EU is holding firm on its commitment to lift restrictions dispite continuing protests from certain member countries. Why then, in view of both its protectionist

past and the magnitude of the automobile industry has the EU embarked upon a free trade policy? Does Europe feel it can finally compete in global auto markets?

In the 1980s, the challenges facing the European automobile industry involved questions of productivity, quality and flexibility.[76] Japanese automakers were the first to find many of the answers to these problems. This was the result of Japan's small domestic market and lack of automobile exports in the late 1950s and early 1960s. In order to stay competitive in such a small market, Japanese automobile manufacturers offered a wide range of models and options by employing a flexible or "lean" production system. They organized strong product development teams that could prepare a new model in slightly over half the time required by a European firm.

Their manufacturing system was built upon flexibility using machines that could be reset quickly to make parts on a batch scale rather than using machines dedicated to making one unchanging part for months on end. Thus, it was possible to change models quickly and introduce innovations frequently. Labor became multiskilled, reversing the de-skilling of Fordism. Parts arrived just in time for installation thereby keeping parts inventory costs low. And finally,

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[76]John Yochelson, ed., *The Future of the U.S.-EU-Japan Triad,* (Washington D.C.: Center for Strategic & International Studies, 1995), p. 19.

in order to ensure high quality parts, car assemblers developed close relationships with suppliers resulting in multi-year contracts and single sourcing of parts.

According to a 1989 study, an average Japanese car producer took 16.8 hours to assemble a car as opposed to 24.9 hours for an American producer and 35.5 hours for a European producer.[77] The same study concluded that "average American performance - under unrelenting pressure from the Japanese transplant [factories] in North America - had improved dramatically, partly by closing the worst plants, . . . and partly by adopting lean production at others. [In 1989], Europe, by contrast, had not yet begun to close the competitive gap".[78] However, by 1993, it is apparent that the situation in Europe had begun to change as evidenced by a 1993 *Fortune* article which began: "The Europeans take on Japan . . . the prospect that the Japanese could grab 18 percent of their market had stirred a new combativeness."[79]

European automobile manufacturers have made great strides in bridging the productivity, quality, and flexibility gaps of past decades. Much of this improvement has come from the competitive pressure of

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[77] James Laux, *The European Automobile Industry,* (New York: Maxwell Macmillan International, 1992), p. 248.

[78] Ibid, p. 248.

[79] Carla Rapoport, *Fortune,* 11 Jan 1993, pp. 82-84.

Japanese automobile plants in Europe. To a lesser degree Japanese investment in other European plants has also enhanced productivity and quality. In the past, European automakers would typically keep one car model on the road for up to a decade (albeit with several facelifts). Now, at the risk of boring consumers in a "mature" market who are no longer captive to only European models, European automobile manufacturers have brought product development lead times down from about five years to two. In 1995 alone, no fewer than 25 new models were launched in Europe - twice the number as in either the U.S. or Japan.[80]

In the productivity arena, new highly efficient plants springing up throughout Europe are helping to close the productivity gap. General Motors' new Eisenich facility in former East Germany and Fiat's new plant in Melfi, Italy are now nearly as productive as the Japanese plants (of which Nissan's British factory is the best in Europe), boasting productivity of 55 cars per employee per year.[81]

Along with structural changes in factory operations, the labor force is also changing. European autoworkers are transforming from semi-skilled workers

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[80] *Economist,* "When Horrid for Car Makers is Smashing for Customers", 30 Sep 95.

[81] Rapoport p. 83, Older facilities such as Renault's Douqi plant in France produced 41 vehicles per employee in 1992. While the Volkswagen plant in Wolfsburg, Germany produced only 29 vehicles.

into well trained multiskilled workers. European companies are also sending managers to Japan to learn Japanese management techniques. Since 1979, the EC has sent more than 400 managers aged 25 to 37 to Japan to study Japanese management practices. The reason, explained Frans Andriessen,[82] then EC Commissioner for External Relations, was to attack the ever widening trade imbalance between the EC and Japan.

Such improvement on the part of European manufacturers has involved considerable pain for the economies involved. In cutting costs to stay competitive, Carla Rapoport stated that in the period 1993-1995 more than 300,000 auto workers were likely to be cut from a West European automobile work force of 1.2 million. Table 11 also provides evidence that significant rationalization already occurred in the industry in Europe between 1991 and 1992. Moreover, Rapoport states, "Go to any major European carmaker today and you'll get a lecture on Japanese production techniques."[83]

Economizing still further, many European automobile manufacturers have formed joint ventures in production and product development. For example, Ford and Volkswagen will soon be making four-wheel-drive vehicles

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[82] *Industry Week,* 1 March 1993, pp. 55-56.

[83] Rapoport, p. 83.

in low-wage Portugal. Nissan and Ford are planning to build a plant to produce vans in Spain. Similarly, Renault and Volvo each bought a chunk of the other's shares a few years ago and are jointly developing a luxury car.

But the European automobile industry's attempts to become more competitive do not stop at the borders of the EU. According to John Richarson, EU head of relations with Japan, European car sales in Japan are finally increasing. In 1995, European car makers sold 221,187 cars in Japan - an improvement of 29.5 percent from 1994 which beats U.S. year over year sales gains in Japan by 18 percent.[84] As of early 1996, Europeans now have a 5 percent share of the Japanese car market, compared to American's 0.9 percent.[85] According to James Rosenstein, a spokesman for the Brussels-based Association of European Automobile Manufacturers, "European car makers have put a lot of effort and money into developing distribution networks, advertising and marketing [in Japan] - and it worked."[86]

Based on the above analysis, it appears that the European car industry is making headway in its competitiveness battle with the Japanese. Productivity

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[84]Shanda Islam, "Soft Talk, No Stick", *Far Eastern Economic Review,* 16 May 1996, p. 74.

[85]Ibid, p. 74.

[86]Ibid, p. 74.

is increasing, (Table 10 shows that production is increasing as employment decreases) as well as the European share of the Japanese automobile market.[87] However, the main negative aspect of such improvement is the loss of 300,000 jobs in Europe (Table 10) which exacerbates an already large unemployment rate - in other words, short term pain for long term gain. But even this negative aspect is partially offset by job creation through foreign direct investment - the subject of the next section.

Section 2- Globalization and Foreign Investment

The last section described some of the measures European automakers are taking to become more competitive with the Japanese. These include modernization, rationalization of facilities and workforce, and foreign market penetration. Yet, the downside to this process was also pointed out - increased unemployment. Still, the story does not end here. In order to put people back to work, European countries have sought foreign investment that will bring in new capital and put their unemployed back to work. Once again, Japan enters the equation as a major provider of foreign capital. What follows is an

[87]Market share increase In Japan are also due in part to the cheaper price of European imports based on the strong Yen.

analysis of the role of foreign investment (Table 12) in the EC and its impact on the stability of EU-Japanese relations.

For years, France was the most outspoken EU member as regarded protecting its home market from Japanese competition. Former French Prime Minister Edith Cresson went so far as to describe the Japanese as "worker ants out to dominate the world". When the European Commission first passed anti-dumping legislation, France was one of the first countries to bring a case against a foreign investor: It accused Japanese-owned Canon of running a "screwdriver operation" in France, using French workers to assemble Japanese-manufactured parts for electronic typewriters. Since that time, France has tried to block the sale of U.K.-produced Nissans on the continent several times, claiming that the cars do not have enough European content. But after its unemployment rate skyrocketed several years ago, France had a sudden change of heart and the welcome mat came out for Japanese investment, as it already had elsewhere in Europe. Thus, by 1993, Japanese investment in the EC totaled $63.9 billion, 15 times the level of EC investment in Japan.[88]

In addition to bringing jobs, Japanese investment has also had other beneficial spillover effects

[88]Robert O'Conner, "Turning Japanese", *The Journal of European Business*, September/October 1993, p. 28.

according to Andrew Lawson of the Confederation of British Industry. He states, "A measurable effect of Japan's industrial presence has been the revival of Britain's electronics industry. British industry had stopped making television sets and other consumer electronics a long time ago. But now, thanks to Japanese subsidiaries in Wales, the U.K. is a net exporter of TVs, radios and hi-fis."[89]

Even though it brings jobs, modernizes certain industries, and stimulates the competitiveness of local producers, does foreign direct investment have any negative aspects? John Dunning, who has studied foreign direct investment in a wide range of countries and industries, concludes that when a country has its own indigenous technological capacity in a particular industry based on its own firms and workforce, foreign investment is more likely to enhance local economies. But, if the host country has limited technological capabilities in an industry, foreign investment is more likely to drive out local competitors and further reduce such capabilities.[90]

The European Union has recognized the latter problem and addressed it by setting domestic content laws for some products. In other words, the end product

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[89]Ibid, p. 33.

[90]John Dunning, *The Globalization of Business,* (London: Routledge, 1993)

produced by a foreign producer doing business in a host country must contain a certain percentage of component parts produced in the host country. In the case of the European automobile industry, 45 percent of the components of an automobile built in the European Union must be manufactured within the Union.[91] Some Japanese producers, such as Toyota, are now exceeding that threshold, finding it more cost effective to utilize European-produced parts. Moreover, some of the parts are beginning to be exported to Japan helping the EU's trade balance with Japan.

All in all, therefore, foreign direct investment appears to be beneficial for Europe. By requiring certain amounts of local content, more jobs are created and technology is transferred from investor to host nation industry. Local content regulations do not seem to have discouraged Japanese investment. Japanese investment has slowed in recent years, but consensus opinion seems to be that the recession in Japan combined with slowing European sales are the primary reasons for the slowdown, rather than in hostile reaction to local content regulations.

In summary, the case of the European automobile industry show that free trade can be win-win. European industry benefits from Japanese competition by

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[91]Nester, p. 328.

rationalizing and becoming more efficient. (As it does so, forms of protection such as the VER begin to wither away as illustrated by the EU commitment to eliminate the VER on Japanese automobiles by 1999.) The Japanese, in turn, benefit from their investments in the Community where unit factor costs are lower than in Japan. Moreover, Japanese investment leads to job creation which at least partially offsets job loss through rationalization. Consumers on both continents also benefit by being given a greater choice of quality vehicles at competitive prices. Thus, competition can foster cooperation.

Chapter Four

The Current State of European Business in Japan

Introduction

In a recent article in *Foreign Affairs,* Fred Bergsten writes, "Economic success in today's world requires countries to liberalize to attract mobile international investment, which goes far in determining the distribution of global production, jobs, profits, and technology. Success also requires countries to compete effectively in international markets rather than simply at home."[92] Peter Drucker echoes Bergsten's second criteria for success when he cites a World Bank study that says that countries that put primary emphasis on making their industries competitive in the world economy, with lesser emphasis on the domestic effects of such policies become the economic superstars.[93]

While it can be seen from the last chapter that the EU has been successful under Bergsten's first criteria - attracting foreign investment - can the same be said of the latter? (While European countries have indeed been

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[92]Fred Bergsten, "Globalizing Free Trade", *Foreign Affairs,* Vol. 75, No. 3, May/June 1996, p. 105.

[93]Peter Drucker, "Trade Lessons From the World Economy", *Foreign Affairs,* Vol. 73, No. 1, p. 107.

successful in attracting foreign investment, it is questionable whether all such actively was solicited during the 1970s and 1980s or whether it entered uninvited but nonetheless unopposed through a half-open door in response to Japanese fear that the door would one day close, in other words, the Fortress Europe concept.) Is EU business willing and able to compete in Japanese markets? And are the Japanese willing and able to let EU business compete in Japan? Finally, what bearing does their success (or lack thereof) have on European-Japanese relations?

Section 1 - European Business Presence in Japan

As pointed out in Chapter One using the example of the high number of Japanese business executives visiting Europe, as opposed to European businessmen visiting Japan in the 1980s, European business relations with Japan have been relatively minor during the post-war era. However, that seems to be changing. EU-Japan trade reached a record high of $119 billion in 1995, up from $99 billion the previous year. But more importantly, the EU-Japan trade gap is narrowing rapidly.[94] It now stands at $21.4 billion as opposed to

[94]Even though the theory of free trade says all participants engaging in trade benefit, balance of trade statistics are commonly used as an indicator of how much more one country benefits relative to another. While the relevance of such a ratio is questioned by some, it seem to have profound domestic and international political repercussions

$33 billion in 1992 (Table 13).[95] Meanwhile, Japan's surplus with the U.S. only fell for the first time last year. However, at $45.6 billion, it is still higher than the 1992 figure of $43.6 billion.

James Rosenstein, a spokesman for the Brussels-based Association of European Automobile Manufacturers, attributes the EU's success to taking a commercial approach in attempting to make headway in the Japanese market, as opposed to the political approach used by the United States.[96] Indeed, other figures also show European progress in entering the Japanese market. For example, in 1992, EU-based firms acquired 37 local firms in Japan - a twofold increase from 1989. While it is well known that European luxury goods have gained market share in Japan over the past few years, other European goods are finding niches in areas that have been neglected by the complacent oligopolistic Japanese cartels. Consider, for instance, the case of Imperial Chemical Industries PLC (ICI), which developed a plastic "mix" that can be used to produce an imitation marble bath. Since baths play such a big part in Japanese

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especially if the perception exists that one country is "losing" to another as the result of somehow manipulating (usually through non-tariff barriers) an otherwise neutral system.

[95]Shada Islam, "Soft Talk, No Stick: Europe's New Approach Toward Japan Pays Off", *Far Eastern Economic Review,* 16 May 1996, p. 74.

[96]Ibid.

domestic life and culture, the product has been highly successful in gaining market share.[97]

The pharmaceutical industry is another good example of a sector where EU technology has often had the technological edge over local firms in Japan. As of 1994, Susan Strange noted that foreign-owned pharmaceutical firms comprised mostly of American, British, Swiss and German companies control 20 percent of the pharmaceutical market in Japan.[98] And with a rapidly aging population in Japan these same world-leading firms appear to be well positioned for growth.

Section 2 - Remaining Barriers in Japan

Despite European companies' improved position in the Japanese market, however, there is general consensus that Japanese non-tariff barriers to market entry are still numerous. However, the Japanese tend to blame the lack of foreign penetration into their markets on poor foreign product quality, inability of foreigners to adjust to the requirements of the Japanese consumer, lack of staying power on the part of foreign executives, and plain lack of effort on Europeans' part.[99] Thus, Katsuo Seiki, director of the West Europe Division of

[97]Strange, p. 7.
[98]Strange, p. 7.

[99]McIntyre, p. 85.

MITI's International Trade Policy Bureau, stated in a 1989 interview that "we like to think . . . that there are already fewer institutional barriers - tariffs, quotas and what have you - in Japan than in Europe and the United States."[100]

Notwithstanding such blanket disclaimers, there are still quite a few significant Japanese impediments to accessing Japanese domestic markets. Foremost in the minds of Europeans are the peculiarities of the Japanese economic and political system, which make the Japanese business environment essentially different. First, there is the existence of large industrial conglomerates which belong to the "*Keiretsu system*". This system is characterized by a network of vertical interlocking companies spanning from supplier to manufacturer and horizontally interlocking companies stretching across industry groups. Each is financed by a large financial institution which is a group member. Such conglomerates are able to engage in far-sighted strategic planning because of each's access to capital and each's comparatively lower costs vis-a-vis competitors. They are also able to weather downturns in the business cycle far better than their competitors and are able to launch strategic alliances with ease to penetrate overseas markets.

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[100]Interview with Katsuo Seiki, *Journal of Japanese Trade and Industry*, March/April 1989.

In addition to the *Keiretsu system*, the Japanese distribution system is significantly different from those of either Europe or the United States. Many Europeans believe that the Japanese system is "rigged". They argue that wholesalers and retailers are tied, through a *Keiretsu*, to a particular manufacturer and cannot consequently be considered as independent competitors. This type of distribution promotes what many Europeans and Americans consider price-fixing and denies market access to outsiders. In other words, products not produced and distributed by members of a *Keiretsu* are essentially barred from the regular Japanese market which imposes high margins over and beyond the original value of the product.

Still, however, there are increasing signs that foreigners are able to break through these barriers using numerous strategies. Susan Strange writes that over time, foreign-owned firms in Japan have developed *Keiretsu*-like relations with suppliers and distributors. She states, "Nippon Lever, for instance, has built up what it regards as a very satisfactory relationship with a Japanese firm that operates vending machines in Tokyo and other big Japanese cities. Nippon Lever supplies the cans of tea and other soft drinks while a Japanese

partner looks after the machines."[101] Consider also these illustrative quotes from recent magazine articles:

> "The web of mutual shareholdings that bind together Japanese *Keiretsu,* as the families of financial and industrial companies such as Mitsubishi or Sumitomo are known, are also being loosened. This is happening only slowly. But if it continues, the trend could have a profound effect on the country's economy . . . Change is being driven by the abysmal [recent economic] performance of corporate Japan."[102]
>
> "A study this year by the Institute for International Economics, a Washington D.C. think tank found a big gap between the wholesale process of many Japanese goods and the process of imports at the dockside . . . In the case of the car business, where retailers need specialist expertise, manufacturers still have tight control of sales networks. [But] in the case of cheaper goods . . . discounters have sprung up selling just about anything, foreign or Japanese, at lower prices. A can of beer can now be bought for $1.65 compared with $2.73 in an off-license."[103]

Moreover, in a 1992 article, Brian Bridges notes that "recent surveys of European subsidiaries operating

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[101]Strange, p. 5.

[102]*Economist,* 3 June 1995, p. 67.

[103]*Economist, 1 July 1995, p. 66.*

in Japan show that they feel less disadvantaged by Japanese practices than their company headquarters back in Europe claim."[104]

EU Asian strategy tends to go beyond Japan however, and includes all East Asia.[105] Assuming that the liberalizing process in Japan will be a long incremental process, European companies are forming strategic alliances with Japan's Asian competitors. A recent agreement between Daimler Benz Aerospace and Samsung of South Korea to jointly develop a regional aircraft is a good example.[106] According to Chung Choi, "These other Asian countries would be optimal alliance partners because of such factors as their greater knowledge of Asian markets, their capital resources, and their detailed knowledge of Japanese business strategies."[107]

Section 3 - The Role of Government

European business and government have played complementary roles in breaking down barriers to entry

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[104]Brian Bridges, "Japan and Europe: Rebalancing a Relationship", *Asian Survey*, Vol. 32, No. 3, 3 March 1992 p. 232.

[105]In 1992, for the first time, EU trade with East Asia rose above that of its trade with North America.

[106]Shada Islam, "Being Practical: EU Seeks Cooperation With Tokyo, Seoul", *Far Eastern Economic Review,* 23 March 1995, p. 21.

[107]Chong Ju Choi et al, "Europe's Asian Opportunities: Learning From the USA and Japan, *European Business Review,* Vol. 95, No. 2, 1995, p. 25.

into the Japanese market just as American business and government have. Over the years, European and American firm-to-firm diplomacy was not unheard of - especially when the Japanese wanted foreign technology to gain market share from competitors.[108] In 1983, a European business lobby, the European Business Community (EBC), was created. Bypassing governments, it uses quiet, informed discussion with relevant Japanese authorities rather than bluster and bullying and the consequent media attention such tactics generate.[109] Even when firm-to-firm or business consultation does not work, European government involvement has been calculated, swinging back and forth from direct confrontation (like the U.S. uses) to more low-key prodding. Over the last few years, the latter formula has worked very well. (The almost one third decrease in the EU trade defecit with Japan shown by Table 13 attests to such success).[110]

But, unlike the United States, the EU has not been using unilateral measures such as quantified sales targets for European products in Japan or the threat of sanctions to pry open the Japanese market. Instead, it

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[108]Susan Strange gives numerous examples of American multinational corporations that were invited into Japan and given concessions in exchange for technology.

[109]Strange, p. 18.

[110]It is noteworthy that the political pressure in Europe for governments to respond publicly to Japanese barriers has not been as significant as in the U.S. This is largely due to the fact that in comparison to the U.S., Japanese exports to and direct investment in Europe are not as significant in dollar terms.

has engaged in painstaking meetings with Japanese trade officials on ways to break down import barriers and speed up economic deregulation. Meetings, although frequent (there were 30 technical meetings in 1995), have been relatively low-profile (not at the ministerial level in Japan and Commission level in the EU). According to a senior EU official, "We engage in quiet negotiations with Japan; the U.S. prefers megaphone diplomacy."[111]

While such quiet diplomacy is going on, government at the EU level continues to prod EU business to make further inroads into Japanese markets.[112] It is also interesting to note how the United States tries to solicit the support of the Europeans in order to create two-against-one situations vis-a-vis the Japanese regarding certain issues. Consider, for example, a recent *Business Week* editorial in which two American economic journalists call on Europeans to lend their voice to the American push for market-opening measures in Japan. They state, "The Europeans must be prepared to back up U.S. actions with their own retaliatory tariffs against Japanese autos, auto parts, and electronic components . . . So far, European negotiators

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[111]Islam, *Far Eastern Economic Review,* 16 May 1996, p. 74.

[112]A 4 May 1994 *Wall Street Journal* article states, "The European Union Trade Commissioner, Leon Brittan, chastised business executives in the 12 member countries for doing less that U.S. and other competitors in seeking export opportunities in Japan."

have let the U.S. do the fighting, knowing Europe will benefit from any new barriers to Japanese products in the U.S. as well as any openings in Japan."[113]

While there may be a certain amount of truth in these statements, in general, European strategy appears to be different. According to Leon Brittan, "The U.S. approach may have worked in the past, but Japan now feels that enough is enough."[114] This is because, observes Susan Strange, the Americans are "preaching to the converted". She points out that the Japanese shift in official and organized business opinion is responding much more to domestic change and pressure than to coercion from the Americans.[115] Such an opinion is also echoed by Reinhard Drifte, director of the East Asia Centre at England's University of Newcastle, who says, "The government is under pressure from domestic industry to open up. There's recognition that that's the only way that the Japanese economy will regain speed and momentum."[116]

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[113]Bill Javetski and John Templeman, "Why Europe Should Be Banging on Japan's Door, Too", *Business Week,* 22 May 1995, p. 60.

[114]Islam, *Far Eastern Economic Review,* 23 March 1995, p. 21.

[115]Strange, p. 17.

[116]Islam, *Far Eastern Economic Review,* 16 May 1996, p. 74.

Section 4 - Conclusion

Based on the previous three sections of this chapter and the discussion of the European automobile industry in the last chapter, it is evident that as of late, European competitiveness has been improving and that the EU is not content to concede Japanese and East Asian markets to foreign competitors. Moreover, the subtle way in which both European business and government have made progress in breaking down Japanese trade barriers seems to emphasize cooperation over conflict. Yet, the story is not finished. As Lester Thurow points out:

> "The world has forgotten what it learned in the 1920s. Bilateral negotiations cannot lead to a stable trading system. To work, a multipolar, integrated, open world economy requires fiscal and monetary coordination among the major countries - Germany, Japan and the United States. A common locomotive is needed, and it can only exist if the major countries stimulate or restrict their economies in unison."[117]

Thurow goes on to point out that coordination among Triad nations has worked during crisis times, such as

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[117]Thurow, p. 60.

the 1987 U.S. stock market crash, when Japan and Germany took immediate action to stimulate their economies in order to avoid recession. However, he believes that during normal times, coordination fails because countries focus inward on domestic problems, ignoring the global economy - an action of which the EU has repeatedly been accused. The result of such a narrow focus, in Thurow's opinion, is the formation of trading alliances with close friends and neighbors who have similar economic systems (trading blocs), while excluding others (beggar-thy-neighbor policies). Such a system would not only be exclusionary, but also cause conflict over whose rules apply when blocs did find it necessary or advantageous to trade with one another.

Yet, based on EU-Japanese trade relations, Thurow's predictions do not seem to be becoming reality. While it is undeniable that regional trade blocs are forming and that fear of exclusion from European markets has been responsible to an extent for Japanese investment in Europe, it does not seem that such trade blocs are as exclusionary as Thurow would have one believe. The GATT process (now WTO) has already significantly lowered tariffs among signatories. Other exclusionary impediments - structural and nontariff barriers - seem to be falling, albeit slowly, as the result of countries' bilateral or multilateral bargaining coupled with economic stagnation. Moreover, all this is

happening in a world no longer characterized by hegemonic stability under the leadership of the United States.

In the Introduction, the question of whether future Triad relations would be characterized by cooperation or conflict was posed. The answer, I believe, based on evidence from EU-Japanese trade relations, is the former. But in the case of EU-Japanese relations, the pressure for cooperation is ironically coming from different places. In the case of Japan it is internal, while in the case of Europe it is external. In other words, domestic pressure for cheaper, higher quality goods is causing the Japanese government to open up while the EU is liberalizing despite domestic pressure for job and benefit protection.

Based on the discussion of the previous two paragraphs, a convergence of outcomes appears to be occurring. In spite of the absence of a hegemon, barriers to trade are falling. And the outcome appears to be the same whether it is brought about by domestic pressure or in spite of domestic pressure.

Such an outcome reflects the already high degree of interdependence among Triad economies. It also buttresses the idea that the concept of "winners" and "losers" is fluid, constantly subject to change. (The term "loser" is a comparative term - relative to someone else. A "loser" relative to a competitor can still be

"winner" in the sense that their economy and living standards are still growing albeit slower than a competitors.) A loser will become relatively attractive as its currency gets weaker and its industries restructure and consolidate. The UK is a good case in point. A "winner", on the other hand, will eventually find its growth moderated or even halted as the result of upward currency valuation and rising wage rates as illustrated by Japan today.[118]

But to prosper, one has to participate. And Europe, indeed, does appear to be participating. The broad international feeling cited by Paul Kennedy, that Europe is less interested in boosting global commerce by opening its markets than it is in protecting its farmers and industrial workers, does not seem to be completely true.[119]

It appears, then, at this point in time, that the Triad of the twenty-first century will be characterized by an economic balance of power. Undoubtedly, conflict will arise from time to time over the rules of the system, which prompts some foreign policy analysts such as Alan Tonelson to state that international institutions such as the World Trade Organization (WTO),

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[118]Kenichi Omhae, *The Borderless World: Power and Strategy in the Interlinked Economy,* (New York: HarperCollins, 1990) p. XII.

[119]Paul Kennedy, *Preparing For The Twenty First Century,* (New York: Random House, 1993) p. 286.

which act as arbiter, cannot escape power realities and that individual countries will approach such institutions with expectations inevitably reflecting their power positions.[120] Although Tonelson would argue, based on his view, that countries might drop out of the WTO if a decision went against them, I do not find such an outcome likely.

I feel that precisely the opposite is apt to happen. The Triad countries will defer to the WTO to "level the playing field" if bilateral relations come up short. As seen throughout this thesis, Triad economies are too interlinked to do otherwise. If a country loses an allegation of unfair trade practices at the WTO, it may have lost a battle but not the war. The ultimate victory will eventually come in the form of standardized trade practices which will add predictability and, therefore, stability to the global trading system.

The EU, therefore, is on the right track in its relations with Japan. As pointed out in Chapter 2, it is already advocating a global trading system based on the WTO. Europe needs and encourages Japanese investment and at the same time realizes that it needs to sell its goods in Japan and East Asia. Likewise, Japan realizes that European companies doing business in Japan, along with the availability of European goods on

[120]Alan Tonelson, "America, Germany, and Japan: the Tenacious Trio?", *Current History,* Vol. 94, No. 595, November 1995, p. 358.

its domestic markets, affords its citizens a better standard of life and improves the competitiveness of its domestic industry. While neither entity will "give away the kitchen sink" in eliminating trade barriers, each has good reason to cooperate with the other. Finally, such cooperation is likely to endure as long as both the EU and Japan continue to have expectations for increased future trade and investment.

Table 1

The EC (Eur 9) and Japan: World Trade and Bilateral Trade (1960–70)

Unit = billion US$

		1960		1970
Extra EC (Eur 9) World trade	Imports	28.7	×2	57.4
	Exports	25.9	×2.1	55.7
Japan's world trade	Imports	4.5	×4.2	18.9
	Exports	4.1	×4.8	19.3
EC trade with Japan	Imports	0.3	×5.9	1.7
	Exports	0.3	×4.7	1.4

Source: Eurostat and Ministry of Finance, Tokyo; Exports FOB, Imports CIF.

Table 2

EC (Eur 9) – Japan Bilateral Trade (1960–81)

Unit: million US$

	Exports	Percentage of total EC extra exports	Japan ranked as export market for the EC	Imports	Percentage of total EC extra imports	Japan ranked amongst EC supplier countries	Balance	Percentage change over previous year	Cover ratio
1960	296	1.1	23rd	304	1.1	26th	− 8	−	97
1963	512	1.8	14th	510	1.5	18th	+ 2	−	100
1965	506	1.4	15th	725	1.8	14th	− 219	−	70
1966	628	1.7	12th	809	1.9	14th	− 181	− 17	78
1967	853	2.1	10th	849	2.0	14th	+ 4	c.t.	100
1968	904	2.1	11th	988	2.1	11th	− 84	c.t.	91
1969	1,086	2.2	11th	1,212	2.3	8th	− 126	+ 50	90
1970	1,384	2.5	11th	1,650	2.8	6th	− 266	+111	84
1971	1,403	2.2	11th	2,191	3.4	7th	− 788	+196	64
1972	1,673	2.3	10th	2,977	4.0	5th	− 1,304	+ 65	56
1973	2,840	2.9	6th	4,187	4.0	5th	− 1,347	+ 3	68
1974	3,303	2.4	10th	5,219	3.3	7th	− 1,916	+ 42	63
1975	2,763	1.8	16th	5,988	3.8	6th	− 3,225	+ 68	46
1976	3,043	1.9	15th	7,154	4.0	6th	− 4,111	+ 27	43
1977	3,529	1.9	13th	8,751	4.5	5th	− 5,222	+ 27	40
1978	4,748	2.1	11th	11,102	4.9	4th	− 6,354	+ 22	43
1979	6,347	2.4	8th	13,421	4.4	5th	− 7,074	+ 11	47
1980	6,364	2.1	12th	18,554	4.9	4th	−12,190	+ 72	34
1981	6,262	2.1	12th	17,366	5.1	4th	−11,104	− 9	36

Note: c.t. stands for change of trend (surplus–deficit).
Source: Eurostat, Exports FOB, Imports CIF. Greece is included for 1981.

Table 3

EC (Eur 9)–Japan Bilateral Automobile Trade (1970–81)

(Number, percentage)

	Registration in the EC of passenger cars imported from Japan	Japan's market share in EC (total registrations)	Registration in Japan of passenger cars imported from the EC	EC's market share in Japan (total registrations)
1970	31,923	0.6	11,313	0.7
1971	52,328	0.9	12,718	0.7
1972	90,286	1.5	17,578	0.8
1973	229,522	2.9	20,525	0.8
1974	218,624	3.3	24,855	1.2
1975	313,645	4.6	25,842	1.0
1976	402,139	5.2	25,318	1.1
1977	467,896	6.8	25,903	1.1
1978	511,422	6.0	34,626	1.3
1979	585,824	7.9	41,586	1.5
1980	756,000	11.1	32,500	1.1
1981	700,000	8.3	29,412	1.0

Source: Japanese passenger cars registered in Europe: The Japan Automobile Manufacturers' Association.
EC passenger cars registered in Japan: The Japan Automobile Importers' Association.

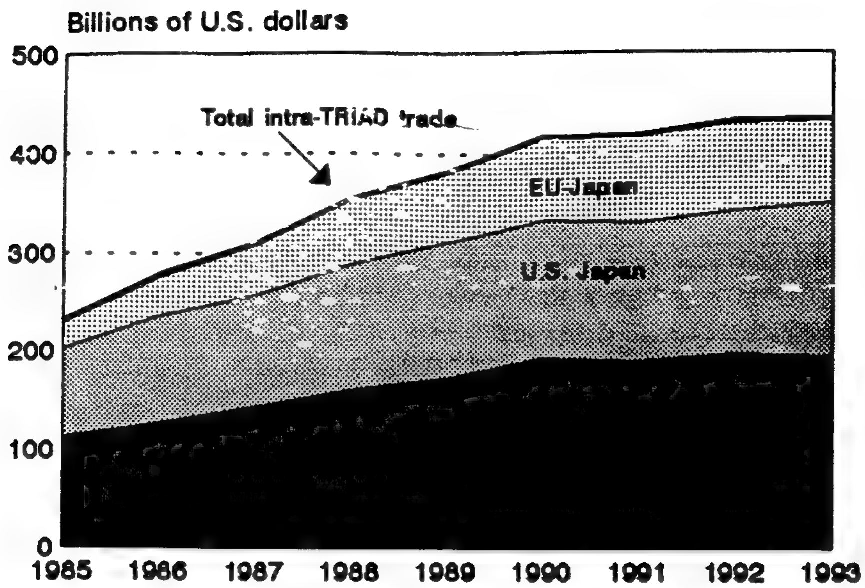
Table 4

IMPORTANCE OF EXTRA-REGIONAL TRADE, 1991

Region	**Total trade (millions)**	**Extra-regional trade**	**As % of total trade**	**As % of GDP**
Americas	$ 1,460,000	$ 784,000	53.70%	10.86%
of which, United States	*$ 929,720*	*$ 623,380*	*67.05%*	*11.11%*
Asia-Pacific	$ 1,638,000	$ 810,000	49.45%	15.46%
of which, Japan	*$ 551,270*	*$ 348,070*	*63.14%*	*10.35%*
W. Europe	$ 3,257,000	$ 915,000	28.09%	13.06%
of which, the European Union	*$ 2,821,450*	*$ 833,850*	*29.55%*	*13.69%*
W. Europe, net of EU intra-trade	$ 1,579,900	$ 915,000	57.92%	13.06%

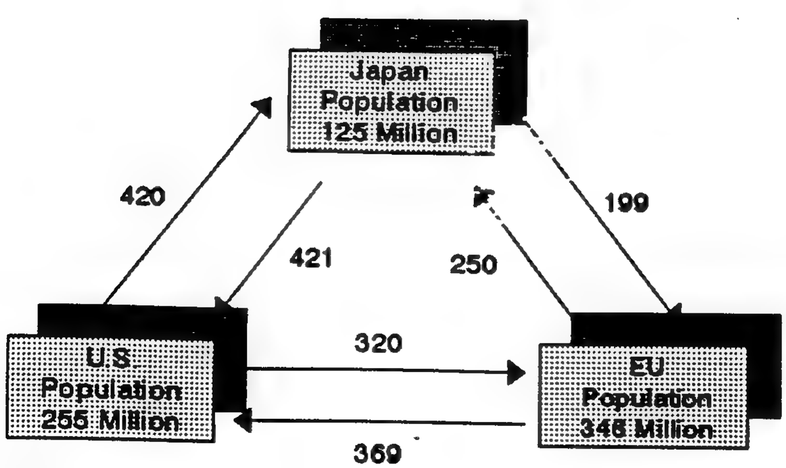
Source: General Agreement on Tariffs and Trade (1993a) and World Bank, (1993b).

Table 5



Source: IMF, *Direction of Trade Statistics*, June 1994, 1993, 1990, 1987.

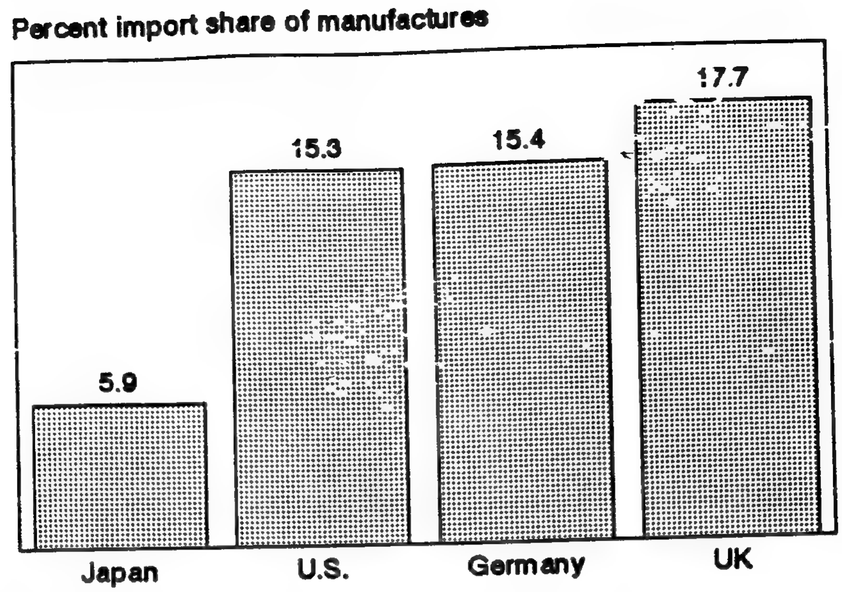
Table 6



Direction of import flow by importer (U.S. dollars, per capita)

Source: Internal figures, Japan, Ministry of International Trade and Industry, Tokyo, 1994.

Table 7



Source: Internal figures, United States Trade Representative, Washington, D.C., 1994.

Table 8

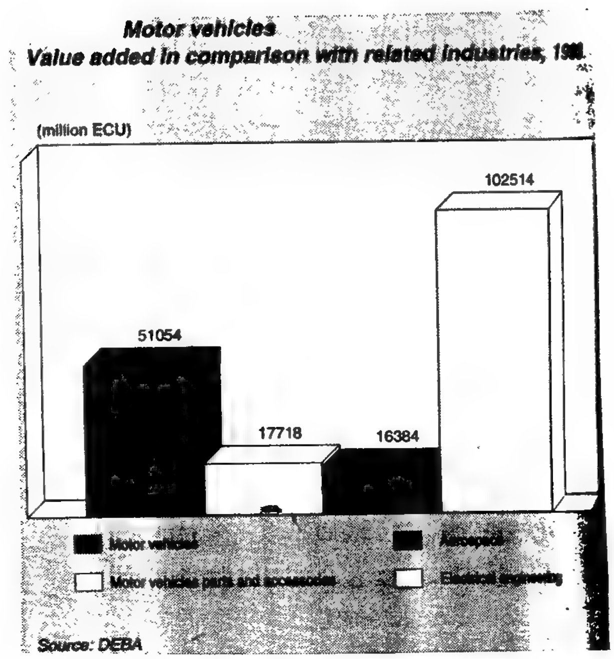
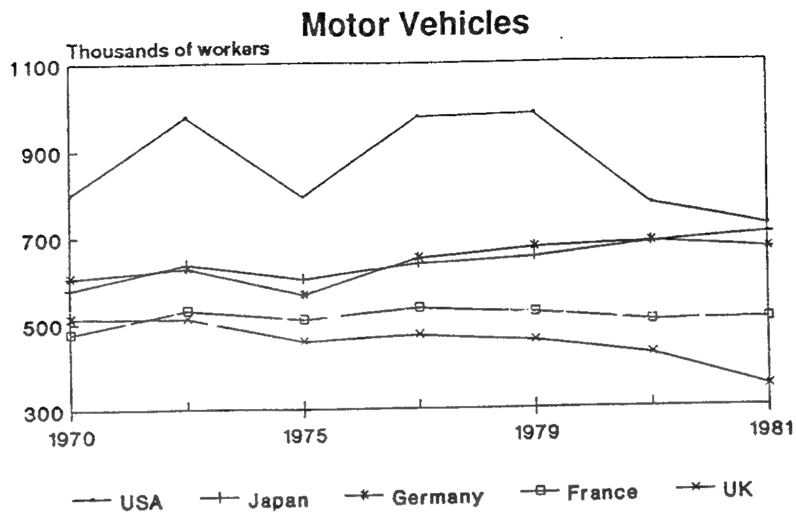
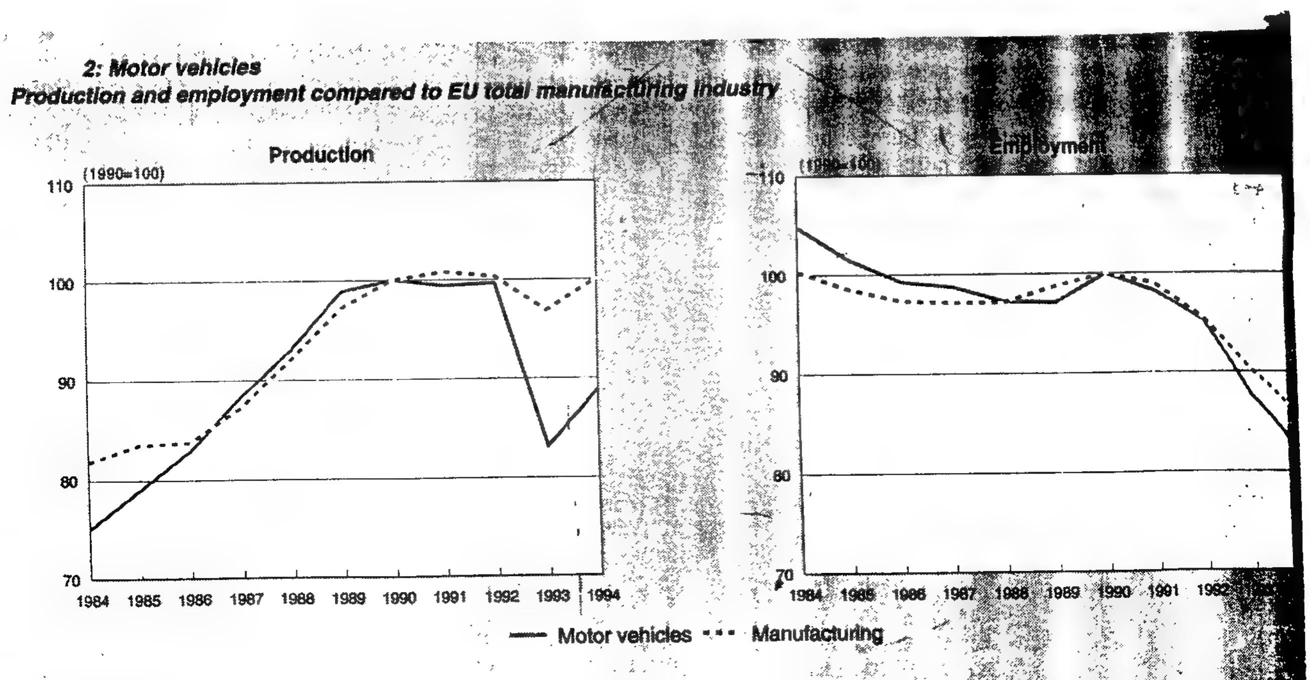


Table 9



Source. Alan Altshuler, Martin Anderson, Daniel Jones, Daniel Roos, and James Womack, *The Future of the Automobile: The Report of MIT's International Automobile Program* (Cambridge, Mass.: MIT Press, 1984), p. 201.

Table 10



1994 are DEBA estimates.
Source:

Table 11

Rationalisations in the European automobile industry, 1991 and 1992

Firm	Location	Type of rationalisation
VW	Germany	To shed 12 500 jobs out of 130 000 over the period 1991–6.
Renault	France	Closed Billancourt (Paris) plant, 1991: 4000 jobs lost. 1992, announced plans to cut 3746 of 120 000 jobs in France.
Saab	Sweden	Over the period 1991 and 1992 total workforce cut by 30%. New assembly plant at Malmo (£250m investment) closed.
Jaguar	UK	From 12 800 employed (1988) to 8500 by the end of 1991. Six-week production halt. 4-day week from August 1991. Further job cuts to leave 7400 end 1991. End 1991, announced further 2000 job losses. August 1992, 700 jobs lost. September 1992, further 120 jobs lost. Jaguar lost £226m in 1991.
Rolls Royce	UK	1991 lost 1200 jobs (30% of total) to leave 3100. 3-day week for much of 1992. Sales fell about 50% in 1991/2. Further cuts to leave only 2100 jobs announced September 1992.
Lotus	UK	1991 workforce cut from 900 to 600. 1992 workforce reduced to 150. Elan production axed after only 2 years. Loss of £15.8m on turnover of £43.2m. Sold by GM 1993.
Fiat	Italy	Plans announced in 1992 for 10 300 job cuts. Prolonged short-time working in many plants. Closure of Desio plant in 1991 with 2500 jobs lost.
GM	Germany	Announced plan in 1992 to reduce 31 000 workforce by 6000 over period to 1997.
Mercedes	Germany	1992 announced plan to cut 10 000 jobs out of 183 000 total in wake of 5.8% pay agreement which would cost the firm DM600m in 1992.
BMW	Germany	1992 announced plan to shed 3000 jobs out of 62,000 in Germany.
Rover	UK	500 jobs out of Longbridge engine and gearbox plant. Total of 3500 jobs (12% of all Rover jobs) cut in 18 months to the end of 1991. Six-month pay freeze imposed October 1992.
Jensen	UK	Went into receivership August 1992.
Ginetta	UK	Went into receivership September 1992.
Mercedes	Germany	Extends holidays for workers, winter 1992. Output cut by 35 000 units. Parent company announces 40 000 jobs to go from 1993.
Volvo	Sweden	November 1992 announces the loss of 9500 jobs (10% of total truck and car) by 1995. Uddevalla (620 jobs) and Kalmar (800 jobs) plants closed. (Might also cut 1200 of 9000 jobs at Volvo Car BV, The Netherlands)
Saab	Sweden	November 1992 announces 1650 jobs to go at Trollhatten plant (20% of total), with 350 jobs elsewhere. Loss of $370m in 1992.
Porsche	Germany	1991/92 loss of $43m, sales down 26%. 1850 jobs (25% of total) cut 1992/93.
Ford	Europe	1991 plans to cut 2500 jobs among white collar workforce to 1994. Cut 10% of indirect workforce a year for 3 years. 512 jobs lost, Transit van plant in Southampton. By 1991 employment at Halewood (UK) down to 7500 from 1970s peak of 14 000. 3-day week at Halewood for much of 1992. Further job losses expected. 1991 net loss of $1.079bn. Other UK plants at Dagenham and Southampton went on to 3-day week towards end of 1992, when Ford announced a further 1550 job cuts in the UK following 2100 announced in February 1992. Assembly plants in Valencia (Spain) and Köln (Germany) also having a series of non-production days.

Sources: Compiled from company reports, company press releases, and press reports.

Table 12

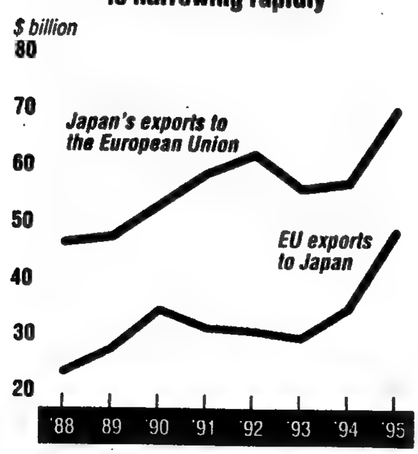
The stock of Japanese direct investment in the EC, 1980–91.

Fiscal year ending 31 March	$ billions	Rate of change (%)
1980–1	3.9	10.7
1981–2	4.5	10.0
1982–3	5.3	10.0
1983–4	6.2	10.1
1984–5	7.7	10.8
1985–6	10.0	12.0
1986–7	13.4	12.6
1988–9	40.0	n/a
1990–1	64.0	n/a

Source: Commission of the EC, relations between the Community and Japan.

Table 13

The EU-Japan trade gap is narrowing rapidly



Source: Ministry of Finance, Japan

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Academic Background

Master of Arts, West European Studies, August 1996, Indiana University, Bloomington, Indiana.

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Military Academic Background

Graduate of:

French Basic Course, February 1995, Defense Language Institute, Monterey, California.

Combined Arms Staff School, May 1992, Fort Leavenworth, Kansas.

Signal Officer Advanced Course, August 1990, Fort Gordon, Georgia.

Signal Officer Basic Course, March 1986, Fort Gordon, Georgia.

Academic Honors

Membership in Omicron Delta Epsilon, Economic Honor Society, 1983.

Work Experience - Captain, Signal Corps, United States Army, Commissioned August 1985, Fort Benning, Georgia.

Jun 1992 - Nov 1993 Brigade Signal Officer, 128th Aviation Brigade, United States Army South, Fort Clayton, Republic of Panama.

Oct 1990 - Mar 1992 Commander, 69th Signal Company, 56th Signal Battalion, 106th Signal Brigade, United States Army South, Fort Clayton, Republic of Panama.

Aug 1987 - Mar 1990 Various positions, 40th Signal Battalion, 11th Signal Brigade, U.S. Army Information Systems Command, Fort Huachuca, Arizona.

April 1986 - Jun 1987 Platoon Leader, 229th Signal Company (Tactical Satellite), 1st Signal Brigade, 8th U.S. Army, Republic of Korea.

Military Honors

Recipient of the Army Aviation Association of America's 1st Annual Avionics Awards, 1992.

Meritorious Service Medal.

Army commendation Medal with Oak Leaf Cluster.

Army Achievement Medal.